



The Eurozone Debt Crisis (2010-2013): How the Single Market Exacerbates the European Divergences

10TH INTERNATIONAL CONFERENCE ON APPLIED ECONOMICS

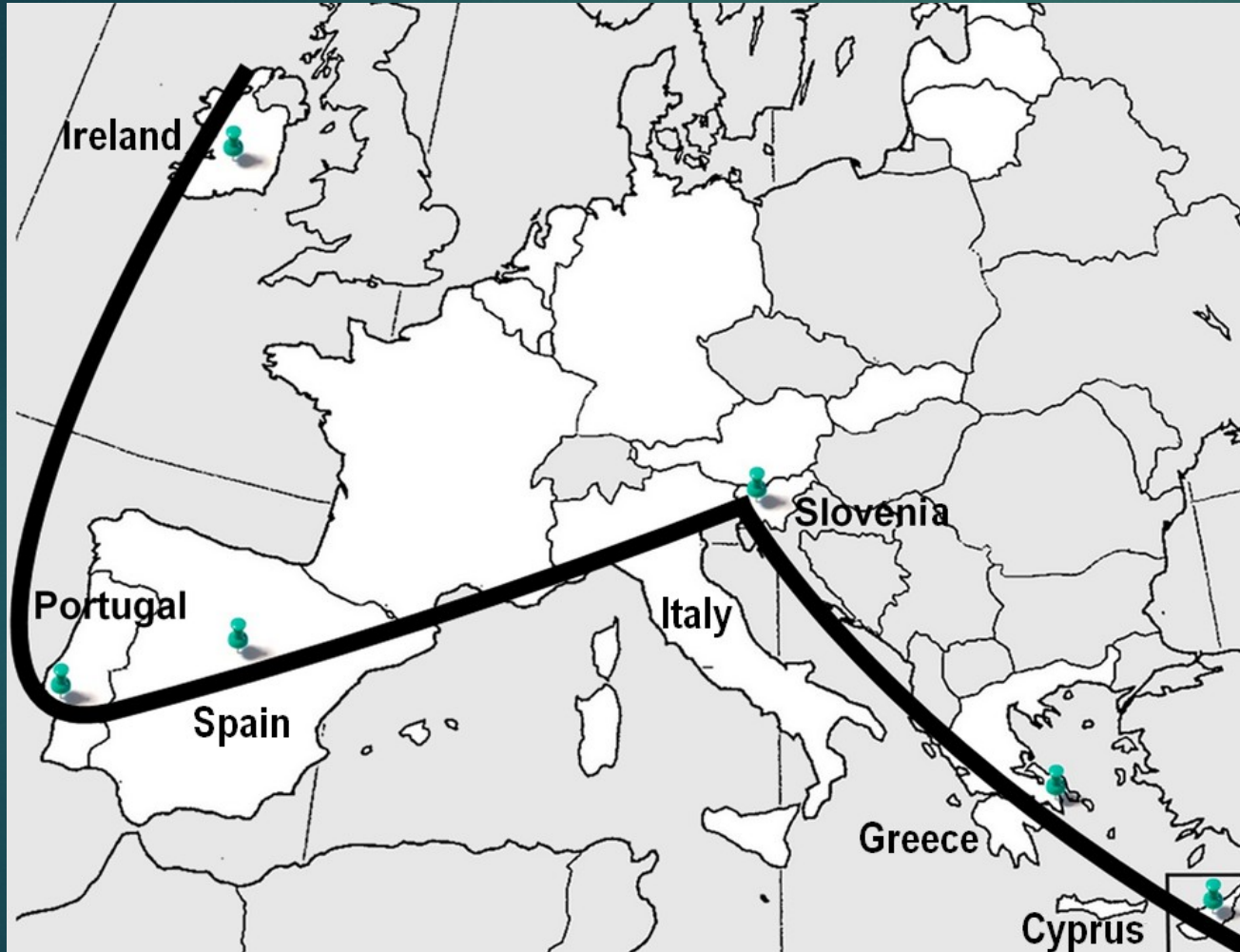
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The Eurozone crisis (2010-2013)

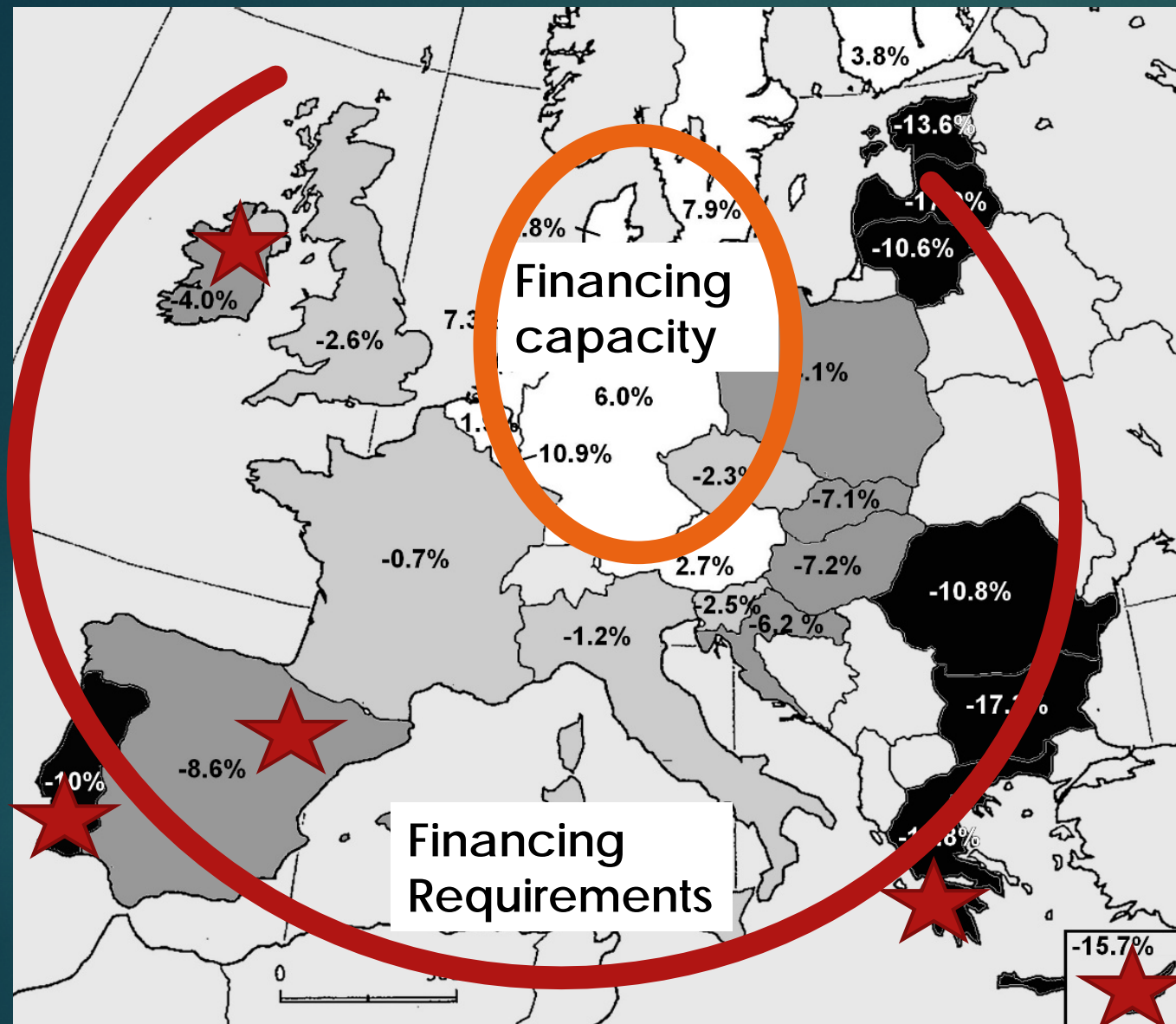
- ▶ Five countries were affected and asked for assistance: Greece (April 2010), Ireland (November 2010), Portugal (April 2011), Cyprus (March 2012) and Spain (June 2012).
- ▶ All of them are different in size and economic characteristics.
- ▶ Two different explanations has been given to explain this crisis by academics and by the European authorities:
 - A *"failure to control national debt"* is emphasized for Greece and Portugal (Baldwin et al. 2015 p. 15).
 - A *"failure to control excessive bank leverage"* for Spain, Ireland and Cyprus (Ibid.)

► Can the geography be part of the explanation?



The affected countries have also two common features:

- They are member of the Eurozone
- They are geographically peripheral in the European Union



Current accounts balance (2005-2007 average) in the European Union.

"From the euro's launch till the Crisis, there were big capital flows from EZ [Eurozone] core nations like Germany, France, and the Netherlands to EZ periphery nations like Ireland, Portugal, Spain and Greece."

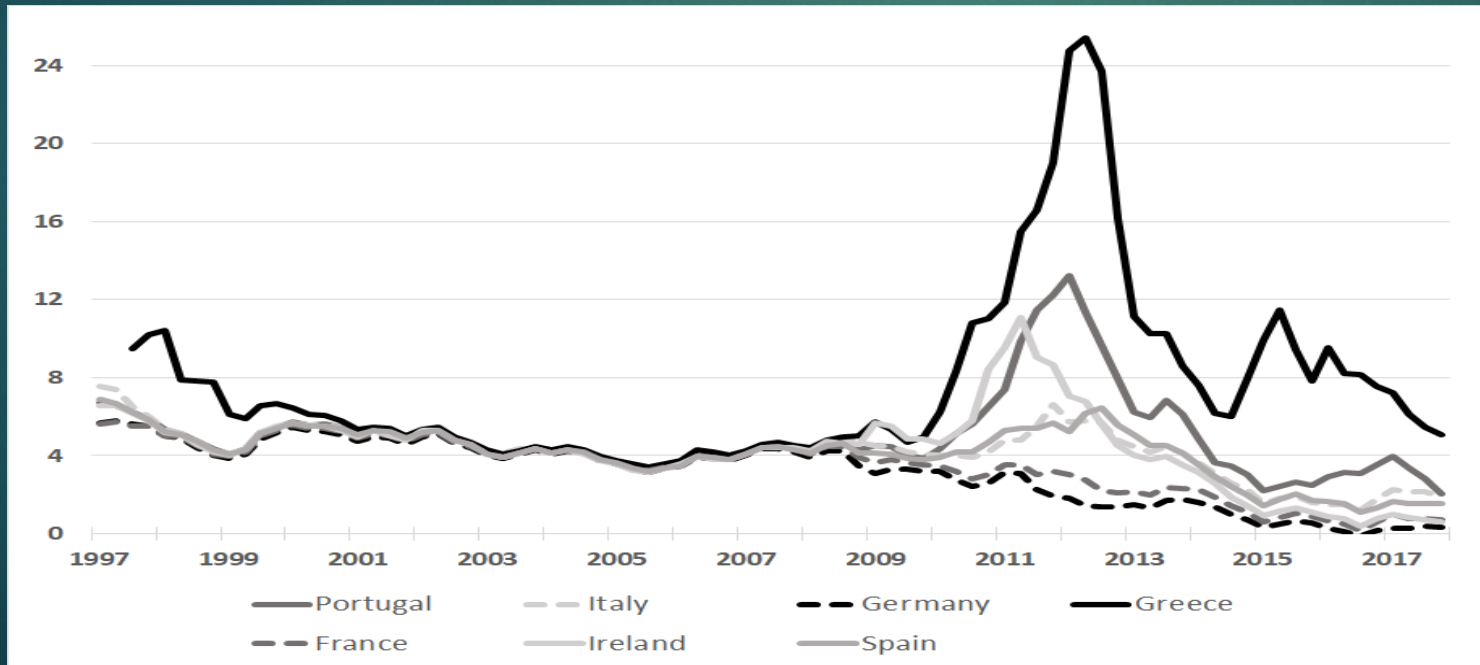
(Baldwin et al. 2015, p. 1)

"the crisis in the Eurozone is a classic debt and balance-of-payments crisis"

(Friedman and Walter 2017).

The Causes of Peripheral countries imbalances

- ▶ Three cumulative effects pushed interest rates down (1997-2007).
 1. The disappearance of exchange rate risk and the creation of a large financial and banking market within the Eurozone has gradually harmonized interest rates, virtually eliminating the spread with Germany.



10 years government bonds yields in the Eurozone (1997-2017)

Source : OECD

The Causes of Peripheral countries imbalances

2. The low German inflation rate and the revaluation of the euro on the foreign exchange markets have contributed to the decline in German rates themselves.
3. Countries with stronger growth such as Ireland, Greece and Spain, experienced inflation above the euro area average. For these countries, real interest rates were therefore lower than in Germany.

—	2000	2001	2002	2003	2004	2005	2006	2007
Germany	1.44	1.98	1.42	1.03	1.67	1.55	1.58	2.30
France	1.68	1.63	1.92	2.10	2.14	1.74	1.67	1.49
Italy	2.54	2.79	2.47	2.67	2.21	1.99	2.09	1.80
Spain	3.43	3.59	3.07	3.04	3.04	3.37	3.51	2.79
Portugal	2.85	4.37	3.60	3.22	2.37	2.28	3.11	2.45
Ireland	5.60	4.87	4.61	3.49	2.20	2.43	3.93	4.90
Greece	3.15	3.37	3.63	3.53	2.90	3.55	3.20	2.90

*Harmonized annual
inflation rate*

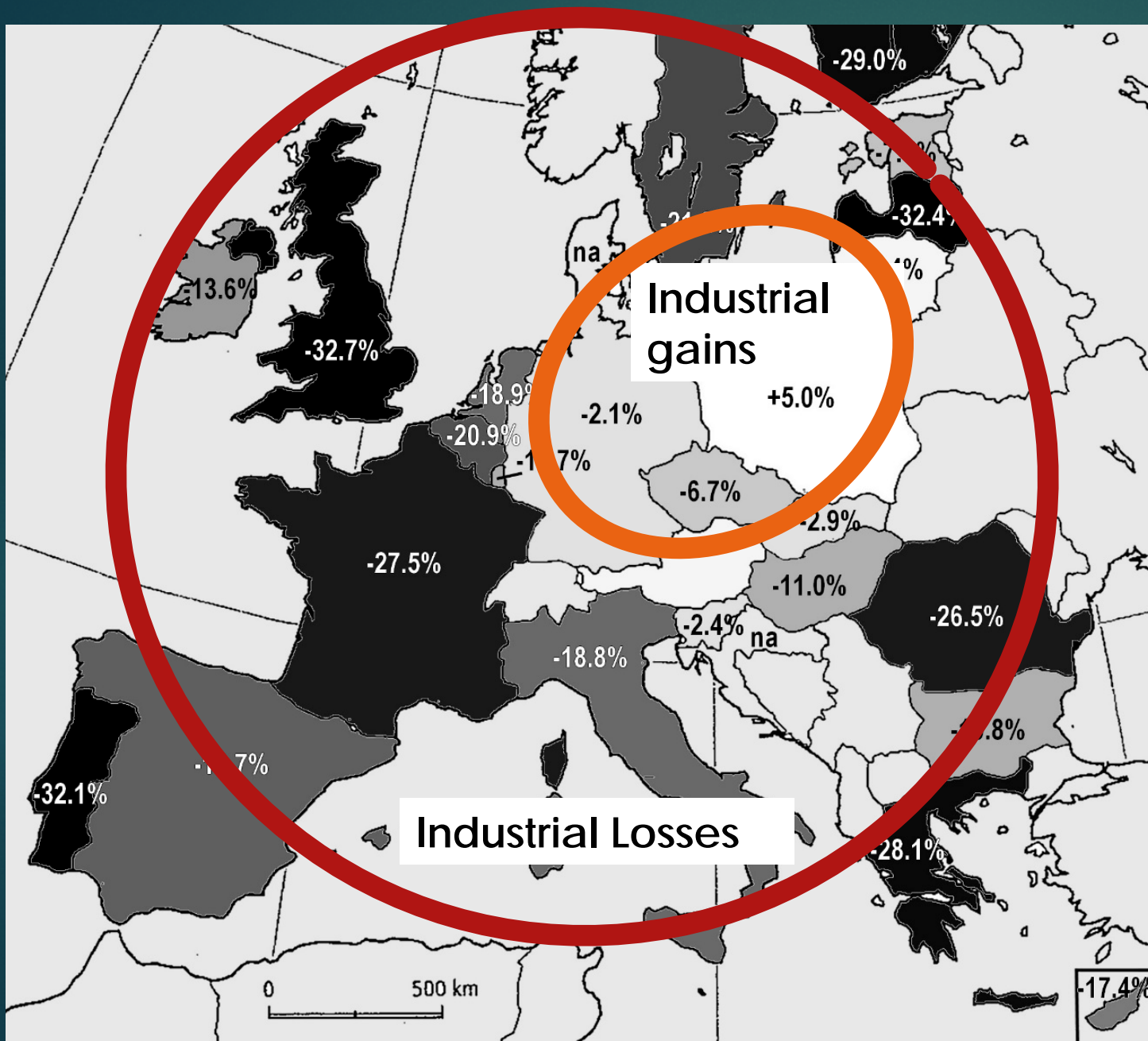
Source : OECD

The Causes of Peripheral countries imbalances

- ▶ The rapid reduction in the cost of borrowing has profoundly changed behaviors for Households, businesses, and the States: In all peripheral countries, (except Italy), the fall in interest rates has led to an **increase in national private and/or public debt**.
- ▶ This leads to the European financial imbalances:
 - In 2007, Greece's external financing needs represented more than 15% of its GDP, those of Spain and Portugal exceeded 9%, and the Irish economy had a financing requirement of 6.5%.
 - Germany and the Netherlands had a current account surplus of 6.74% and 6.94% of GDP respectively.
 - The French and Italian economies had a slight current account deficit: -0.29% of GDP for the former and -1.39% for the latter (OECD).

The Causes of core countries financial surpluses

- ▶ The recovery in the current account balances of the core Eurozone countries appears are spectacular:
 - Austria's current account balance moves from a deficit of 2.26% of GDP in 1999 to a surplus of 4.49% in 2008
 - German transforms an external deficit of 1.42% of GDP in 1999 into a surplus of over 5% from 2006 and over 8% since 2015.
- ▶ The causes of surpluses in the core countries are not clear since borrowing rates have also fallen in these countries. The very strong increase in savings in these economies **must therefore find a non-financial source**.
- ▶ It can be explain by an industrial boost and an excess in the **trade balance**.



Changes in the volume of work performed in manufacturing industry between 2000 and 2017 in the European Union.

Source: Eurostat

Mobile and Territorial Production Factors and the Agglomeration Effects

"Once an industry has chosen a community in this way, it is likely to stay there for a long time, given the great advantages for people involved in the same qualified industry to be close to each other. The secrets of the industry cease to be secrets; they are almost in the air, and children unconsciously learn many of them. We appreciate the work well done; we immediately discuss the merits of inventions and improvements made to machines, processes, and the general organization of the industry. If someone finds a new idea, it is immediately taken up by others, and combined with ideas of their own, thus becoming the source of other new ideas. Soon subsidiary industries were born in the neighbourhood, providing the main industry with instruments and raw materials, organizing its traffic, and allowing it to make many different economies."

Marshall, Alfred
(1890), *Principles of political economy*

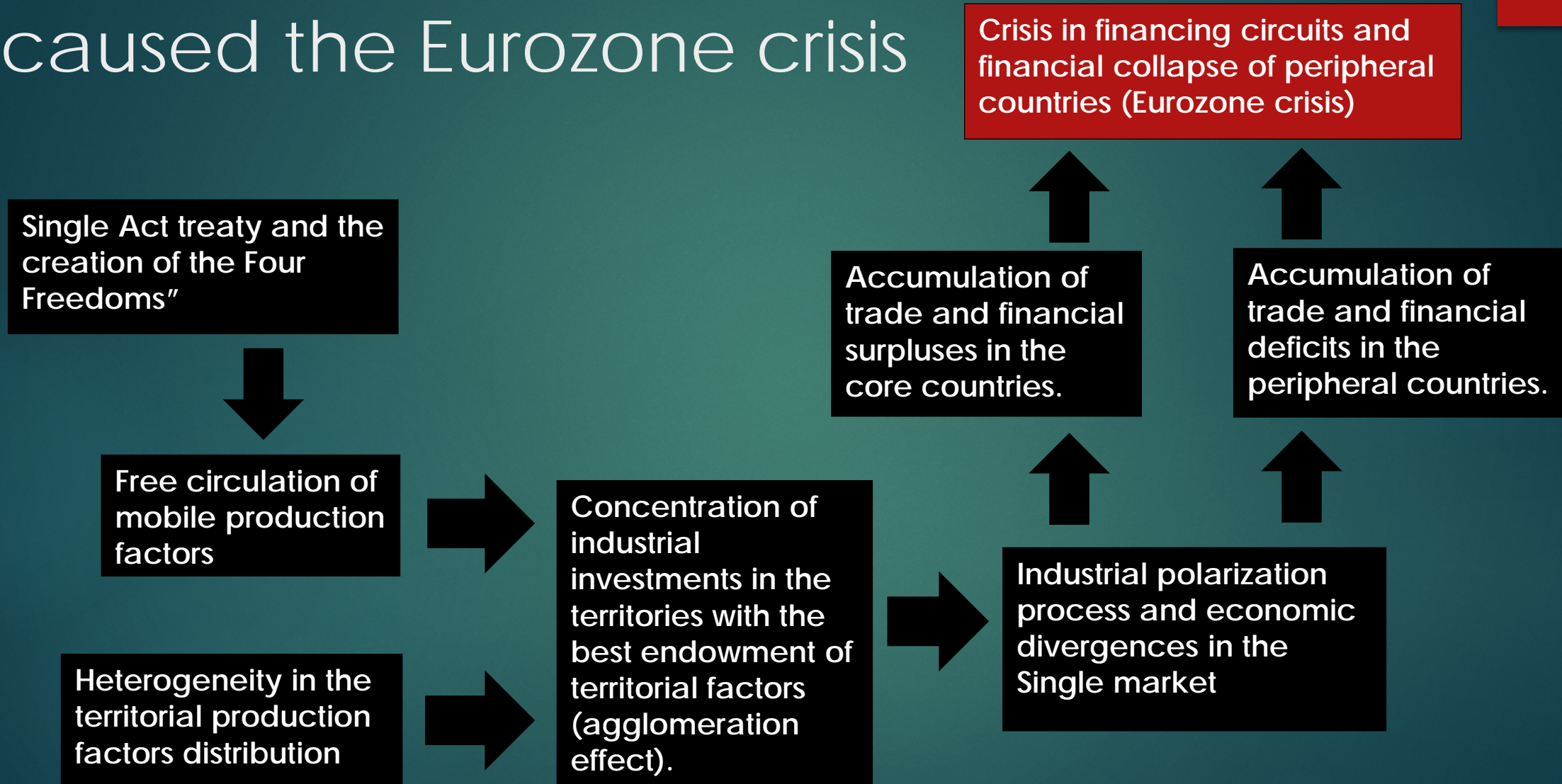
Mobile and Territorial Production Factors and the Agglomeration Effects

- ▶ The emergence of Marshallian industrial districts are due to positive externalities (Meade 1952) produced by the emergence of territorial production factors. Similar concepts can be found in M. Porter's **clusters** (1990) and in P. Krugman's **agglomeration effects** (1991).
- ▶ Territorial production factors emerge from:
 - A large and qualified **workforce**, which is more important as the number of industrial companies rises;
 - **Innovations**, which are facilitated by competitive emulation and imitation of nearby companies;
 - The development of support and complementary activities such as **transport infrastructure**. The greater the industrial activity in a region, the more profitable and growing the transport systems, especially rail and maritime transport systems, will be.

How the Single Market creates an Industrial Polarization Process

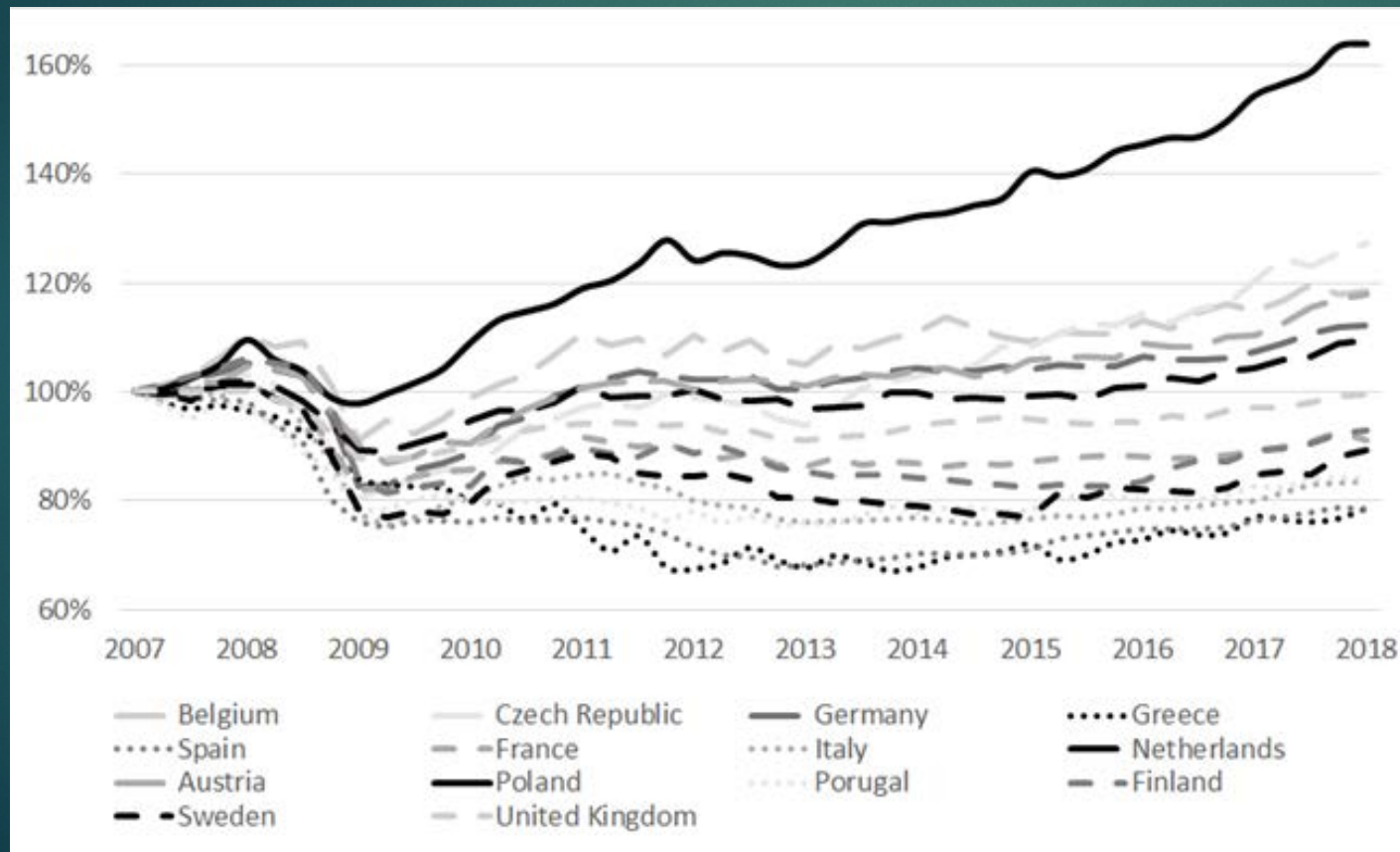
- ▶ The **Single European Act** in 1986 marked a further step in the unification of the European economy and also changed its nature by organizing the **free movement of production factors** instead of the commodities alone (common market):
- ▶ The Four Freedoms regime:
 1. Free movement of goods;
 2. Free movement of services;
 3. Free movement of capital;
 4. Free movement of labor.
- ▶ By introducing the Four Freedoms, the European economy has made free competition the only mechanism for regulating the markets, strictly forbidding any national industrial policy.
- ▶ But because the territorial production factors are not equally shared, the Single market logic leads to a **polarization effect** in the European industrial organization.

How the Four Freedoms caused the Eurozone crisis




As a Conclusion...

- Inadequate diagnostic leads to inadequate medicine. By implementing austerity policies in peripheral countries the European authorities has deepen the industrial causes of the crisis and the European divergences.



Evolution of the industrial production index in Europe from the first quarter of 2007 (base 100) to the first quarter of 2018

Source: Eurostat



Thank you for your attention!